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real estate management association shall be considered that association which, based on all the facts and circumstances, it more closely resembles. In addition, those paragraphs shall be applied based on conditions existing on the last day of the organization's taxable year.

(b) *Condominium management associations.* Substantially all of the units of a condominium management association will be considered as used by individuals for residences if at least 85% of the total square footage of all units within the project is used by individuals for residential purposes. If a completed unit has never been occupied, it will nonetheless be considered as used for residential purposes if, based on all the facts and circumstances, it appears to have been constructed for use as a residence. Similarly, a unit which is not occupied but which has been in the past will be considered as used for residential purposes if, based on all the facts and circumstances, it appears that it was constructed for use as a residence, and the last individual to occupy it did in fact use it as a residence. Units which are used for purposes auxiliary to residential use (such as laundry areas, swimming pools, tennis courts, storage rooms and areas used by maintenance personnel) shall be considered used for residential purposes.

(c) *Residential real estate management associations.* Substantially all of the lots or buildings of a residential real estate management association (including unimproved lots) will be considered as used by individuals as residences if at least 85% of the lots are zoned for residential purposes. Lots shall be treated as zoned for residential purposes even if under such zoning lots may be used for parking spaces, swimming pools, tennis courts, schools, fire stations, libraries, churches and other similar purposes which are auxiliary to residential use. However, commercial shopping areas (and their auxiliary parking areas) are not lots zoned for residential purposes.

(d) *Exception.* Notwithstanding any other provision of this section, a unit, or building will not be considered used for residential purposes, if for more than one-half the days in the associa-

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tion's taxable year, such unit, or building is occupied by a person or series of persons, each of whom so occupies such unit, or building for less than 30 days.

[T.D. 7692, 45 FR 26322, Apr. 18, 1980; T.D. 7692, 45 FR 24879, May 23, 1980]

§ 1.528-5 Source of income test.

An organization cannot qualify as a homeowners association under section 528 for a taxable year unless 60 percent or more of its gross income for such taxable year is exempt function income as defined in § 1.528-9. The determination of whether an organization meets the provisions of this section shall be made after the close of the organization's taxable year.

[T.D. 7692, 45 FR 26322, Apr. 18, 1980]

§ 1.528-6 Expenditure test.

(a) *In general.* An organization cannot qualify as a homeowners association under section 528 for a taxable year unless 90 percent or more of its expenditures for such taxable year are qualifying expenditures as defined in paragraphs (b) and (c) of this section. The determination of whether an organization meets the provisions of this section shall be made after the close of the organization's taxable year. Investments or transfers of funds to be held to meet future costs shall not be taken into account as expenditures. For example, transfers to a sinking fund account for the replacement of a roof would not be considered an expenditure for the purposes of this section even if the roof is association property. In addition, excess assessments which are either rebated to members or applied against the members' following year's assessments will not be considered an expenditure for the purposes of this section.

(b) *Qualifying expenditures.* Qualifying expenditures are expenditures by an organization for the acquisition, construction, management, maintenance, and care of the organization's association property. They include both current operating and capital expenditures on association property. Qualifying expenditures include expenditures on association property despite the fact that such property may produce income which is not exempt function income.

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Thus expenditures on a swimming pool are qualifying expenditures despite the fact that fees from guests of members using the pool are not exempt function income. Where expenditures by an organization are used both for association property as well as other property, an allocation shall be made between the two uses on a reasonable basis. Only that portion of the expenditures which is properly allocable to the acquisition, construction, management, maintenance or care of association property, shall constitute qualifying expenditures.

(c) *Examples of qualifying expenditures.* Qualifying expenditures may include (but are not limited to) expenditures for:

- (1) Salaries of an association manager and secretary;
- (2) Paving of streets;
- (3) Street signs;
- (4) Security personnel;
- (5) Legal fees;
- (6) Upkeep of tennis courts;
- (7) Swimming pools;
- (8) Recreation rooms and halls;
- (9) Replacement of common buildings, facilities, air conditioning, etc;
- (10) Insurance premiums on association property;
- (11) Accountant's fees;
- (12) Improvement of private property to the extent it is association property; and
- (13) Real estate and personal property taxes imposed on association property by a State or local government.

[T.D. 7692, 45 FR 26322, Apr. 18, 1980]

§ 1.528-7 Inurement.

An organization is not a homeowners association if any part of its net earnings inures (other than as a direct result of its engaging in one or more exempt functions) to the benefit of any private person. Thus, to the extent that members receive a benefit from the general maintenance, etc., of association property, this benefit generally would not constitute inurement. If an organization pays rebates from amounts other than exempt function income, such rebates will constitute inurement. In general, in determining whether an organization is in violation of this section, the principles used in

making similar determinations under Section 501(c) will be applied.

[T.D. 7692, 45 FR 26323, Apr. 18, 1980]

§ 1.528-8 Election to be treated as a homeowners association.

(a) *General rule.* An organization wishing to be treated as a homeowners association under section 528 and this section for a taxable year must elect to be so treated. Except as otherwise provided in this section such election shall be made by the filing of a properly completed Form 1120-H (or such other form as the Secretary may prescribe). A separate election must be made for each taxable year.

(b) *Taxable years ending after December 30, 1976.* For taxable years ending after December 30, 1976, the election must be made not later than the time, including extensions, for filing an income tax return for the year in which the election is to apply.

(c) *Taxable years ending before December 31, 1976, for which a return was filed before January 31, 1977.* For taxable years ending before December 31, 1976, for which a return was filed before January 31, 1977, the election must be made not later than the time provided by law for filing a claim for credit or refund of overpayment of taxes for the year in which the election is to apply. Such an election shall be made by filing an amended return on Form 1120-H (or such other form as the Secretary may prescribe).

(d) *Taxable years ending before December 31, 1976, for which a return was not filed before January 31, 1977.* For taxable years ending before December 31, 1976, for which a return was not filed before January 31, 1977, the election must be made by October 20, 1980. Instead of making such an election in the manner described in paragraph (a) of this section, such an election may be made by a statement attached to the applicable income tax return or amended return for the year in which the election is made. The statement should identify the election being made, the period for which it applies and the taxpayer's basis for making the election.

(e) *Revocation of exempt status.* If an organization is notified after the close of a taxable year that its exemption for such taxable year under section 501(a)